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No. 8

# Legislative Notice

Editor, Judy Gorman Prinkey

April 21, 1999

## S. 96 — Year 2000 (Y2K) Act

Calendar No. 34

Reported from the Committee on Commerce, Science, and Transportation on March 10, 1999, with an amendment in the nature of a substitute, by a vote of 11 yeas (all Republican members) and 9 nays (all Democrat members); S. Rept. 106-10; Minority views filed.

### NOTEWORTHY

- The Majority Leader has indicated his intent to take up S. 96 this week. Senator Hollings is expected to object to the motion to proceed; if so, a cloture petition will be filed.
- S. 96 encourages remediation and non-litigious solutions to problems associated with the year 2000 computer problem. It allows businesses and governments to concentrate initially (up to 90 days after a computer failure) on fixing those problems rather than defending lawsuits.
- The purpose of S. 96 is to provide incentives for solving technical issues related to Y2K problems before failures occur, and to encourage efficient resolution of Y2K problems when they do occur. In the event of litigation, the bill would impose reasonable limits on liability. The bill's interests are to avoid overwhelming the nation's judicial system as well as to avoid severe damage to the nation's economy.
- Negotiations to date have resulted in an accord with Senator Wyden to make some changes to the reported bill that would focus the measure more on consumer protection. Those changes may be offered as a McCain-Wyden substitute. Also, additional negotiations continue between the Commerce and Judiciary Committees, although the bills (S. 461 was reported by Judiciary) are very similar.
- The legislation is supported by a broad coalition of the nation's businesses — large and small (including the U.S. Chamber of Commerce, National Association of Manufacturers, National Federation of Independent Business, and National Retail Federation) — who would find themselves both as potential plaintiffs as well as defendants. The Association of Trial Lawyers of America and most consumer groups oppose the bill as reported.

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## HIGHLIGHTS

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### Summary of Major Provisions

The intent of the bill is to encourage companies to prevent Y2K failures, to remedy problems quickly if they do occur, and to impose reasonable limits on liability for injuries resulting from such problems.

- The bill encourages resolution of disputes arising from Y2K failures through **alternative dispute resolution (ADR)** rather than through expensive and time-consuming litigation.
- The bill requires a prospective plaintiff to give a **30-day notice** to a company it intends to sue to provide the company an opportunity to correct the problem. If the potential defendant elects to fix the problem, the defendant would then be entitled to a **60-day remediation period** before the lawsuit could be filed.
  - This is a critical time-frame, because once a lawsuit is filed — particularly a class action lawsuit — a company or a government entity must divert resources to responding to that suit, resources that otherwise could be devoted to delivering the product or service.
- **Contractual rights and obligations of parties are preserved.** Where the parties have already contracted for remedies and resolution of Y2K problems, the contract will control.
- Defendants would be **liable only for their proportion of the fault**, with certain exceptions such as fraudulent conduct by the defendant or where plaintiffs have limited assets.
- **Punitive damage limitations** are included in the bill, with caps at the greater of \$250,000 or three times actual damages for bigger businesses (that is, 25 or more full-time employees), or the lesser of these figures for small businesses (fewer than 25 employees). There would be no limit on punitive damages in cases where a defendant intentionally injured a plaintiff.
  - Punitive damages are intended to provide a deterrent from the defendant repeating the behavior. Because the Y2K problem is unlikely to recur, punitive damages in this instance effectively become merely a windfall to plaintiffs and attorneys.
- **No punitive damages may be awarded against governmental entities.**
  - This provision in the bill ensures that taxes are not raised to pay punitive damages, although government entities still may be liable for economic damages.
- The legislation **does not affect personal injury claims**, and so those who suffer personal injury from Y2K-related computer problems will have the same avenues of redress as are currently available.

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## BACKGROUND

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The "Y2K" problem arises from the manner in which dates are coded and computed in computerized information systems. Computer systems historically have been programmed using two digits to represent the year, for example "98" instead of "1998," in order to minimize data storage requirements (which was especially critical in earlier computers), and to reduce operating costs. Using a two-digit format, however, makes "2000" indistinguishable from "1900," or "2001" from "1901." In addition, 2000 is a leap year, raising additional date coding concerns. When a computer is unable to recognize or compute the "00" date code used in 2000, it may fail to operate, process or transmit the data, or may fail altogether. Because of the widespread use of computers in our society, the problem extends from the desktop PC to bank systems to national power grids. The problem is international in scope, posing concerns for the entire global economy.

Because this problem is potentially so widespread, there is concern as to whether our society will be faced with a crisis situation on January 1, 2000. The cost of fixing the problem in all affected systems, both public and private, is extraordinary: the estimated overall cost in the United States ranges from \$200 billion to \$1 trillion.

On top of those outlays, Lloyd's of London has estimated the cost of litigation anticipated to be generated in the United States alone at over \$1 trillion.

Nevertheless, the actual impact of the problem remains unclear. Some technical analysts predict that widespread failures in systems across the country, including power outages, stalled assembly lines, and halted international transactions could result in a major nationwide, or even worldwide, recession. Others contend that the efforts already underway or completed will ensure a nearly disruption-free transition into 2000.

A number of Y2K lawsuits already have been filed either based upon failures or anticipated failures. The potential for litigation to overwhelm the nation's judicial system, and to cause severe damage to the nation's economy require incentives for proactive solution of the problems before they occur, and prompt resolution of those failures which do occur.

The threat of litigation has resulted in a climate of fear and reluctance by many companies to acknowledge the potential problems which may be caused by their products. This atmosphere is disruptive to the stability of the nation's interstate commerce.

It was against this backdrop that the demand arose for the Congress to foster an environment that would encourage problem solving and discourage litigation. The Commerce Committee reported S. 96 on March 10, 1999, and the Judiciary Committee reported its version, S. 461 (Hatch-Feinstein), on March 26, 1999.

A broad coalition of the nation's business community — who could serve both as plaintiffs and potential defendants — has endorsed the legislation. This coalition includes businesses large and small represented by the U.S. Chamber, the National Association of Manufacturers, the National Federation of Independent Business, the National Retail Federation, and the Information Technology Association of America, among dozens of other employer groups and associations.

The trial lawyers and most consumer groups oppose the legislation. However, the liberal Progressive Policy Institute answers the critics of this legislation by making three important points: First, those who suffer personal injury from Y2K-related failures will continue to have the same avenues of redress and opportunities for compensation as are currently available because this legislation does not affect personal injury claims. Second, the legislation works to ensure that larger businesses are not favored over smaller ones or one party in a suit over another. Third, by promoting Y2K remediation rather than unsubstantial and burdensome litigation, the big winner will be the U.S. economy and the U.S. consumers who will not indirectly have to bear up to \$1 trillion in litigation costs, with a healthy share going to lawyers.

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## **BILL PROVISIONS**

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### **SECTION-BY-SECTION ANALYSIS OF MAJOR PROVISIONS OF S. 96**

**[This information comes from the McCain-Wyden working draft, as of 4/16/99]**

#### **Section 2. Findings and Purposes**

The purpose of S. 96 is to prevent potential disruptions to the nation's economy and commerce caused by litigation arising from Y2K problems, by providing incentives for solving the technical issues before failures occur, and by encouraging efficient resolution of Y2K problems when they do occur. The potential Y2K failures result from the use of a two-digit code for defining the year in computer programs, software, chips and systems. Some 40 lawsuits already have been filed either based upon failures or anticipated failures. The potential for litigation to overwhelm the nation's judicial system, and to cause severe damage to the nation's economy, requires incentives for proactive solution of the problems, and an orderly means of addressing Y2K failures which do occur.

#### **Section 3. Definitions**

Includes definitions of "Y2K action" describing bill's reach. The definition of "person" specifically includes federal, state, and local government entities.

#### **Section 4. Application of Act**

Applies to any Y2K action brought in a Federal or State court after February 22, 1999. Creates no new causes of action. Does not cover claims for personal injury or wrongful death. Does not supersede a contract between a plaintiff and defendant. Any written term or condition of a contract between a plaintiff and defendant, including limitations or exclusions of liability and disclaimers of warranty, is fully enforceable, unless it is in direct conflict with state statute in effect January 1, 1999, addressing that term of the contract. A court can determine that contract as a whole is unenforceable. If the contract is silent on a matter, the interpretation of the contract with respect to that matter shall be determined by applicable law at the time the contract was executed.

Preempts state law to the extent that it establishes a rule of law for Y2K actions that is inconsistent with state law.

### **Section 5. Punitive Damage Limitations**

Does not establish a right to punitive damages where none is provided in applicable state law. Prohibits punitive damage awards against government entities. Caps punitive damages at the greater of \$250,000 or three times compensatory damages for big businesses, or the lesser of these figures for small businesses. Defendants who have intentionally injured the plaintiff are excepted from the caps.

### **Section 6. Proportionate Liability**

As a general rule, liability in a Y2K action is several and not joint, and defendants are liable only for their share of responsibility as a percentage of the responsibility of all persons (whether the persons are parties or not) at fault. Exceptions are: 1) if there is an uncollectible share and if plaintiff has a net worth of \$200,000 or less and the damages award is more than 10 percent of his liability, then remaining defendants must assume "orphaned share"; 2) if a defendant has to pick up an orphan share, it won't be in an amount greater than 50 percent of the proportionate share of that defendant; 3) if a defendant intentionally defrauded the plaintiff, then the defendant is jointly and severally liable.

### **Section 7. Pre-Litigation Notice**

Requires plaintiffs to give 30 days' notice to defendants before commencing Y2K action against defendants (except when seeking only injunctive relief). If the defendants don't respond to the notice within 30 days and describe what action they will take, plaintiffs may commence suit after 30 days. If the defendant agrees to fix the problem and/or agrees to alternative dispute resolution (ADR), then there is a 60-day remediation period before the plaintiff can file a suit. If the plaintiff files suit without giving notice, the defendant may treat the filing as a notice and the court shall stay discovery and all other proceedings for 90 days. In a class action, the notice period is applicable only to the named plaintiffs.

### **Section 8. Pleading Requirements**

Requires specific information in complaint about nature and amount of damages and factual basis for calculation. Materiality requirement: If the plaintiff alleges that a product or service is defective, the complaint must contain specific information about the manifestations of the material defects and facts supporting a conclusion that the defects are material. Required state of mind: If a plaintiff is required to prove the defendant's state of mind, the complaint must state with particularity the facts giving rise to a strong inference that the defendant acted with the required state of mind.

### **Section 9. Duty to Mitigate**

Damages in a Y2K action shall exclude damages that the plaintiff could reasonably have avoided in light of disclosures or other information that the plaintiff was, or reasonably could have been, aware of. This includes defendants' reasonable efforts to advise purchasers or users about ways to remedy or avoid the Y2K failure.

### **Section 10. Application of Existing Impossibility or Commercial Impracticability Doctrines**

If breach of contract is alleged, the doctrines of impossibility and commercial impracticability in force under applicable law on January 1, 1999, shall apply. "Nothing in this Act shall be construed as limiting or impairing a party's right to assert defenses based upon such doctrines."

### **Section 11. Damages Limitation by Contract**

A contract between the parties controls the nature of the remedies available for its breach or repudiation. If there are no express provisions regarding remedies, then state law at the time the

contract was effective controls, or by operation of Federal law (for example, contracts with Federal agencies).

### **Section 12. Damages in Tort Claims**

A party making a tort claim cannot recover "economic loss" ("economic loss" which does not include actual damages), unless economic loss is provided for in a contract to which the party is a party; such losses result directly from a personal injury claim resulting from a Y2K failure; or such losses result directly from damage to tangible property other than the property that is the subject of the contract, and the losses are permitted under state law. The economic loss rule does not pertain to certain enumerated actions, including patent, trademark, defamation and invasion of privacy.

### **Section 13. State of Mind; Bystander Liability; Control**

**Defendant's State of Mind:** In a claim for money damages in which the plaintiff must prove the defendant's actual or constructive knowledge of an actual or potential Y2K failure, the plaintiff must prove the elements of the claim by clear and convincing evidence.

**Bystander Liability:** This provision covers third parties who have not manufactured or sold, produced, or provided the product or service that suffers a Y2K failure. Where that person is also not in privity with the defendant by contract, or by relationship, then state of mind must be proven by clear and convincing evidence that the defendant actually knew, or recklessly disregarded a substantial risk that the Y2K failure would occur. This heightened proof is not required in cases of negligence.

**Control Not Determinative of Liability:** The fact that a Y2K failure occurred in a facility, system, etc., within a person's control shall not be the sole basis for recovering damages against that person.

### **Section 14. Liability of Officers and Directors**

Subject to lower monetary caps in state law, charter, or bylaw authorized by state law, the liability of directors, trustees, officers, or employees is capped at \$100,000 or pre-tax compensation in the year preceding the act or omission. The caps do not apply if it is shown by clear and convincing evidence that the person intentionally made misleading statements about the Y2K problem or intentionally withheld information she had a legal duty to disclose regarding the business' Y2K problem that likely would result in an actionable Y2K failure.

### **Section 15. Appointment of Special Masters or Magistrates for Y2K Actions**

Reiterates F.R.C.P. 53 that allows a district court to appoint a special master or magistrate to hear the evidence and make findings.

### **Section 16. Y2K Actions as Class Actions**

In any Y2K action involving a claim that a product or service is defective, the action can be maintained as a class action as to that claim only if the court finds that the alleged defect was material as to a majority of the class members.

**Notice:** In addition to any other notice required by law, the court shall direct notice of a Y2K action to each member of the class. The notice must describe the nature of the action, the jurisdiction, and the fee arrangement with counsel.

Settlement: No settlement can be approved by the court before the class has been certified.

Forum for Y2K class actions: Expands original jurisdiction of U.S. District Courts for Y2K actions where there is minimal diversity, but provides that district courts may abstain from hearing the case if there is a predominant state interest (most members are from same state as primary defendants and state law will apply) or where the amount in controversy is minimal, the class is small, or the primary defendants are states or other entities against whom the district court may not order relief. In Y2K actions, permits removal by any defendant or any plaintiff class member.

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## ADMINISTRATION POSITION

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At press time, no Statement of Administration Policy was available. On March 1, 1999, John Koskinen, the Chairman of the President's Council on Year 2000, released the following statement regarding the legislation as it was then drafted (we excerpted this from Senator Hollings' Minority Views):

The bills before the Judiciary and Commerce Committees focus on liability litigation, which is not a Year 2000 readiness issue. In fact, I have serious doubts that these bills will do anything to enhance readiness and increase the number of systems able to effectively make the century transition. In addition, we need to ensure that discussion speculating about the possibility of voluminous litigation does not inadvertently increase the possibility of unnecessary overreaction by the public as a result of a misperception about the magnitude of the number of systems that will fail.

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## COST

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The Congressional Budget Office estimates that the net effect of S. 96 would most likely be a savings to the federal court system, as well as to state and local governments, but CBO cannot estimate the extent of any such savings because it cannot predict the number of lawsuits that would arise — under either S. 96 or current law — from computer failures associated with the year 2000.